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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 4/30/84 **Number:** 168978CA **Due By:**

Subject: Cabinet Council on Commerce and Trade - May 2, 1984
10:00 A.M. - Roosevelt Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☐
Attorney General	☑	☐
Interior	☐	☐
Agriculture	☑	☐
Commerce	☐	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☑	☐
Energy	☑	☐
Education	☐	☐
Counsellor	☑	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Jenkins	☐	☑
Mc Farlane	☐	☑
Svahn	☑	☐
CCCT/Gunn	☑	☐
CCEA/Porter	☐	☐
CCFA/	☐	☐
CCHR/Simmons	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/	☐	☐

REMARKS:

The Cabinet Council on Commerce and Trade will meet on Wednesday, May 2, at 10:00 A.M. in the Roosevelt Room.

The agenda is as follows:

Trade Law Revision (CM#379) background paper is attached

DCI
EXEC
REG

RETURN TO:

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☐ Tom Gibson

☐ Don Clarey
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THE SECRETARY OF COMMERCE
Washington, D.C. 20230

April 30, 1984

MEMORANDUM FOR: Cabinet Council on Commerce and Trade

From: MB Malcolm Baldrige
Chairman Pro Tempore

Subject: Trade Law Reform

Legislative Status

On April 10, the House Ways and Means Committee reported H.R. 4784, the Trade Remedies Reform Act of 1984. While the Administration supports reform of our antidumping (AD) and countervailing duty (CVD) law, and most provisions in the bill,*/ H.R. 4784 contains three highly objectionable provisions:

- Industrial Targeting -- Would amend the countervailing duty law to cover so-called "export targeting practices."
- Natural Resource Subsidies -- Would amend the countervailing duty law to state that a natural resource subsidy would exist whenever a government sells a natural resource product to domestic industries at a price below the export price or the fair market value (the price a willing buyer would pay a willing seller in an arm's length transaction).
- Downstream Dumping -- Would amend the antidumping law to state that downstream dumping occurs when a product subject to an antidumping or countervailing duty investigation incorporates materials or components that were themselves sold at less than fair value. The provision would apply if the dumped material

*/ H.R. 4784 contains a number of relatively technical amendments that the Administration strongly supports. For example, the bill would (a) permit greater use of sampling techniques and averaging in antidumping investigations; (b) eliminate interlocutory judicial review; (c) give standing to ad hoc industry-labor coalitions; (d) require verification only in those administrative reviews in which revocation is proposed; (e) provide that where antidumping and countervailing duty investigations are initiated contemporaneously, there would be only one ITC injury hearing covering both proceedings; (f) direct the Secretary of Commerce to undertake a study of adjustments in antidumping proceedings; (g) eliminate administrative reviews where not requested by either petitioner or respondent; and (h) clarify that where a suspension agreement is intentionally violated, the U.S. Customs Service shall undertake a Customs fraud investigation.

or component has "a significant effect on the cost of manufacturing or producing the merchandise under investigation." For example, if a valve producer in Country A sold valves at less than fair value to an engine producer in Country B, and these engines were subsequently exported to the United States, dumping duties could be levied on the engines to reflect the benefit derived from the sale of valves at less than fair value.

These proposals are contrary to the international obligations of the United States, represent dangerous international precedents, and pose direct or indirect threats to American exports. Attachment #1 provides a detailed analysis of these provisions and our objections to them.

Future Legislative Prospects

We now anticipate that H.R. 4784 could go to the House floor before Memorial Day. It has a good chance of passing the House with the Administration-opposed sections on industrial targeting, natural resource subsidies, and downstream dumping intact.

The bill enjoys the support of the same coalitions that twice passed the Local Content bills. Indeed, H.R. 4784 has an even broader support base, since it affects a wider variety of labor unions and industries negatively affected by import penetration over the past four years (such as steel, textiles and machine tools). Members supported local content legislation to send a message to the Japanese. They might see this bill as sending a message to the world that the U.S. will no longer tolerate high levels of import penetration, foreign government assistance to U.S. exports, or frustrating GATT dispute irresolution.

On the Senate side, John Danforth (R-Mo.), Chairman of the Subcommittee on International Trade of the Finance Committee, has asked the Administration to draft amendments to the AD and CVD law. Three members of the Subcommittee -- John Chafee (R-R.I.), John Heinz (R-Pa.) and George Mitchell (D-Me.) -- have urged him to report a bill to the Senate floor for action this year. Danforth is not enthusiastic but Senate action is not entirely out of the question.

Recommendation

- o That the Administration, while continuing to favor certain reforms of the AD/CVD laws, vigorously oppose H.R. 4784 as written because of the objectionable provisions outlined above.

- o That Cabinet and other senior Department officials (particularly from USTR, State, Agriculture and Commerce) make themselves available for a concerted Administration effort to inform members of Congress of the strength of Administration opposition.

ADMINISTRATION OPPOSITION TO PROVISIONS OF H.R. 4784 RELATING TO EXPORT TARGETING SUBSIDIES, NATURAL RESOURCE SUBSIDIES, AND DOWNSTREAM DUMPING

1. Inclusion of Government Export Targeting Subsidies Within the Scope of the Countervailing Duty Law

The Administration strongly opposes section 104(a)(1) of the bill. Section 104(a)(1) would amend the countervailing duty law to cover so-called "export targeting" practices.

a. Although the Administration believes that targeting is unfair, we disagree with the bill's attempt to solve the problem through amendments to the countervailing duty laws. The countervailing duty laws were designed to prevent U.S. industries from being injured by foreign subsidy practices. "Targeting," as the term is generally understood, is not a subsidy practice, but a deliberate government policy of protecting and fostering infant export industries.

We believe that careful scrutiny of section 104(a)(1) demonstrates the impossibility of converting the countervailing duty law into a remedy for targeting. Despite the Subcommittee's efforts to define "targeting" and to create viable legal standards, the targeting provisions of the bill are unworkable.

Instead, we believe that targeting must be addressed at a governmental level, through the GATT, through U.S. diplomacy, and through the possible use of U.S. retaliation under section 301 of the Trade Act of 1974 (19 U.S.C. 2411). As a matter of principle, the United States should first pursue a multilateral solution to targeting in the GATT. Until it can be shown that the existing GATT rules are inadequate to deal with protectionism for infant export industries, we should avoid doing violence to the international trading system by a unilateral expansion of our countervailing duty law. This course reduces the risk of unnecessary confrontation and strengthens the GATT. We can also pursue foreign government targeting through bilateral diplomacy. If foreign governments fail to respond to the GATT or bilateral diplomacy, the United States can retaliate pursuant to section 301 of the Trade Act of 1974 against unreasonable and unjustifiable foreign government practices which burden U.S. commerce.

b. Although we recognize that the Subcommittee sought to create a workable definition of "targeting," we believe that the bill's definition is so broad as to include legitimate forms of government behavior and indeed many programs of the United States government. The bill defines "targeting" as "any government plan or scheme consisting of coordinated actions . . . the effect of which is to assist the beneficiary to become more effective in the export of any class or kind of merchandise." Many legitimate government policies have the effect of benefiting export competitiveness. Our space program, for example, had the effect of aiding U.S. exports of computers, semi-conductors, and satellites, even though its purposes were wholly unrelated to export promotion. Defense Department procurement has the effect of benefiting U.S. exports of aircraft and aerospace products. Many agricultural programs have the effect, but not the purpose, of aiding the competitiveness of U.S. agricultural exports. In short, we believe that the language of the bill is so broad as to sweep up legitimate government programs and subject them to countervailing duties.

Although the bill goes on to provide specific examples of "targeting" activity, these examples raise similar problems of overbreadth. For example, the bill defines targeting to include "assistance in planning and establishing joint ventures which have an anticompetitive export effect, the relaxation of antitrust rules normally applied to beneficiaries to assure the development of anticompetitive export cartels, the providing of assistance in planning or coordinating joint research among selected beneficiaries to promote export competitiveness . . . ." Nevertheless, this language appears to cover various antitrust exemptions administered by the United States. The Department of Justice and the Federal Trade Commission regularly review corporate mergers to determine whether the mergers comply with the antitrust laws. The Export Trading Company Act (96 Stat. 1233) and the Webb-Pomerene Act (15 U.S.C. §61 et seq.) allow export associations formed by U.S. firms to obtain exemptions from the antitrust laws if they meet certain criteria and register with the FTC or the Department of Commerce. The U.S. Department of Justice regularly grants antitrust exemptions to joint research and development ventures formed by U.S. companies. Indeed, the Department recently approved several joint R & D ventures in the computer industry. These government antitrust activities arguably fall within the bill's definition of targeting. The bill therefore illustrates the problem of attempting to distinguish government practices that constitute "targeting" from those practices that plainly do not.

c. In our judgment, the targeting provisions of the bill would be impossible to administer and apply. The bill would require the Commerce Department to quantify the "full benefit of the subsidy." We are not aware of any rational way of quantifying the economic benefits of home market protection, an antitrust exemption, or restrictions on foreign investment, particularly when such conduct occurs over a long period of time and in different market conditions. This problem is compounded by the nature of the countervailing duty law, which requires the Department of Commerce to allocate the amount of the subsidy to the price of the imported product. In our judgment, it would be impossible to quantify a price advantage derived from such conduct in a fair, consistent, and realistic manner. Determinations of the amount of a "targeting" subsidy would be inherently speculative and arbitrary, and at risk on judicial review. In short, the targeting provisions would introduce an uncertain and arbitrary element to the countervailing duty law, a result wholly contrary to the purposes of the bill.

d. The export targeting amendments of section 104(a)(1) invite the implementation of "mirror legislation" by our trading partners. If these provisions are enacted into law, they will be copied by many of our major trading partners who have antidumping and countervailing duty laws of their own. These countries could seek to apply countervailing duties to U.S. exports which benefit from government funding or from antitrust exemptions. Thus, countervailing duties could be levied on U.S. exports which benefit from the procurement practices of the Department of Defense or NASA, U.S. agricultural policies, and other legitimate government practices that have the effect of indirectly aiding the competitiveness of our exports.

The amendments also create a risk that foreign governments will retaliate against U.S. exports. We cannot assume that other countries will stand by if the United States unilaterally expands the definition of a subsidy in a manner contrary to international understandings, particularly if the U.S. interpretation results in the imposition of countervailing duties for programs that other countries perceive as legitimate government policies. The United States is already the most aggressive interpreter and enforcer of the Subsidies Code. Further distancing us from our trading partners is likely to provoke challenges to our interpretation of a "subsidy," and could result in GATT authorization to retaliate.

e. Many of the targeting amendments are unnecessary, since they cover practices already prohibited by the U.S. countervailing duty law or better addressed through the GATT. To the extent that targeting is associated with domestic or export subsidies, these subsidies are subject to the imposition of countervailing duties under existing U.S. law. While the bill would add specific language regarding "[t]he exercise of government control over banks and other financial institutions that requires the diversion of private capital on preferential terms to specific beneficiaries or into specific sectors," this language would not alter existing law or administrative practice. The Department of Commerce has consistently treated government-directed preferential financing from banks as a countervailable subsidy. See, e.g., Certain Steel Products from the Republic of Korea, 47 Fed. Reg. 57535 (Dec. 27, 1982).

In addition, the United States can challenge many of the targeting practices listed in the bill under existing provisions of the GATT. The bill refers to various targeting practices, including "[s]pecial protection of the home market" and investment restrictions, including domestic content and export performance requirements." Under Article III of the GATT, a contracting party must provide "national treatment" to the products of other GATT signatories. Article III prohibits discriminatory import restrictions and domestic content requirements. Thus, after a complaint by the United States, a GATT Panel recently found that domestic content requirements contained in Canada's Foreign Investment Review Act (FIRA) were contrary to the General Agreement. Similarly, the use of quotas to protect domestic markets generally is prohibited by Article XI of the GATT. In our judgment, the GATT is the appropriate forum to challenge government practices that have the effect of protecting and fostering infant export industries.

2. Natural Resource Subsidies

The Administration also strongly opposes the "natural resources" amendments contained in section 104(a)(1) of the bill. Section 104(a)(1) would amend section 771(5) of the Trade Agreements Act of 1979 to reach special "natural resource" subsidies. Under the bill, a natural resource subsidy would exist whenever a government sells a natural resource product to domestic industries at a price below the export price or the fair market value (the price a willing buyer would pay a willing seller in an arms-length transaction).

a. The natural resources amendments represent a major departure from longstanding U.S. and international practice regarding the definition of a subsidy. Under existing U.S. law, subsidies are potentially countervailable only if provided to a "specific enterprise or industry, or group of enterprises or industries." As the U.S. Court of International Trade held in Carlisle Tire & Rubber Co. v. United States, Slip Op. 83-49 (C.I.T. May 18, 1983):

> [A]doption of Carlisle's literal view that generally available benefits are a bounty or grant would, if taken to its logical extreme, lead to an absurd result. Thus, included in Carlisle's category of countervailable benefits would be such things as public highways and bridges, as well as a tax credit for expenditures on capital investment even if available to all industries and sectors.

The court concluded:

> To suggest, as Carlisle implicitly does here, that almost every import entering the stream of American commerce be countervailed simply defies reason. Moreover, in such a circumstance the burden that would be placed on the administering authority would be overwhelming, representing far more than mere administrative inconvenience.

The proposal would also go well beyond the internationally accepted definition of subsidy. A countervailable domestic subsidy is government action or direction that attempts to give one or more industries a special advantage over other industries in the same economy. Since all governments undertake numerous measures which alter economic conditions, it has become a fundamental principle of international and U.S. law that government programs and activities which are generally available -- such as irrigation projects, high quality transportation systems, investment tax credits, capital cost recovery allowances, police and fire protection, rural electrification programs, and public health programs -- are not considered to be countervailable domestic subsidies, even though such activities could be said to benefit companies by indirectly lowering their cost of production. Generally available domestic programs do not distort allocations of resources within an economy. Absent

any distortion of resource allocation, domestic programs merely assist the economy as a whole, not particular industries or sectors. Section 104(a)(1) would violate these principles by subjecting generally available programs to countervailing duties.

b. For the United States to undertake a drastic and unilateral departure from the internationally accepted definition of a countervailable subsidy would expose U.S. exports to a serious risk of retaliation. We believe that the adoption of the natural resources amendments would subject the United States to a GATT challenge, which we would almost certainly lose. The result could be GATT authorization to retaliate against U.S. exports.

c. Even if we succeed in persuading our trading partners to adopt our definition of a subsidy, the result would be an hollow victory, since the expansion of the Subsidies Code to cover natural resources subsidies would expose U.S. exports to countervailing duties elsewhere. The United States regulates the price of natural gas. During the late 1970s, when natural gas prices in the United States were lower than world prices, exports of U.S. textiles were a source of major friction between the United State and the European Community. The EC argued that such textiles benefited from low U.S. natural gas prices. While the Administration has supported the deregulation of natural gas, natural gas prices remain subject to regulation. As a result, U.S. textiles and petrochemicals, which arguably benefit from natural gas controls, would be potential targets for foreign countervailing duties. We note that other U.S. industries benefit from government control of natural resources. For example, Western agricultural products benefit from government irrigation projects, while industries in the Tennessee Valley and the Pacific Northwest benefit from government electricity. Exports from these areas would be in jeopardy.

d. In the petrochemical sector, U.S. firms have significant investments in foreign countries with abundant hydrocarbon natural resources. Some countries maintain differential pricing systems and arguably fall within the bill's requirement that the cheap natural gas "is not freely available to United States producers for purchase of that product for export to the United States." To deny these firms access to the U.S. market for the goods they produce in these foreign countries raises questions about the fairness and consistency of our investment policy.

e. The natural resources provisions of the bill are unfair because they would prevent developing countries with abundant natural resources from capitalizing on their comparative advantage. The effect of the bill is to compel a developing country with an abundance of cheap natural resources either to raise its domestic price to world market levels or to lower its export price from world market levels to the domestic price level. Accordingly, the bill would prevent the developing country from using cheap natural resources to encourage the establishment of domestic industries or alternatively from realizing the profits of exporting its natural resources.

f. The natural resources amendments represent an intrusion into the sovereign affairs of foreign nations. Many developing countries have chosen to exploit an abundance of cheap natural resources by (1) encouraging the establishment of downstream industries in the home market and (2) realizing profits from the sale of natural resources abroad. It is true that this choice involves lost "opportunity costs," i.e. a decision to forgo potential profits. Nevertheless, as long as domestic sales are above the production cost and realize a profit, they cannot be deemed irrational, unreasonable, or economically unsound. Governments, in general, do not necessarily behave like private companies and maximize profits. Instead, they sometimes adopt broader economic and social perspectives. Such policies should not be challenged under our countervailing duty laws, unless they represent a subsidy in the generally understood meaning of the word.

3. Downstream Dumping

The Administration strongly opposes section 104(b) of the bill. While the idea of attacking downsteam dumping has a certain amount of theoretical appeal, we believe that section 104(b) would violate Article VI of the GATT, cause serious unfairness to innocent purchasers, and result in abstract and unrealistic calculations of dumping.

As defined in the bill, downstream dumping occurs when a product subject to an antidumping or countervailing duty investigation incorporates materials or components which were themselves sold either for less than the purchase price in the country where the material or component was manufactured or at less than the cost of production. The provision would apply if the dumped material or component has "a significant effect on the cost of manufacturing or producing the merchandise under investigation." For example, if a valve producer in Country A sold dumped valves to an engine producer in Country B, and these

engines were subsequently exported to the United States, dumping duties could be levied on the engines to reflect the benefit derived from the dumped valves.

a. The downstream dumping provisions of the bill would violate the GATT. GATT Article VI:1 defines dumping as the sale at less than fair value of a like product. Thus we compare only prices (or production costs) of the product imported into the U.S. subject to an antidumping investigation, and of a like product sold in the home market or a third country. An input (e.g., a valve) is not "like" the product into which it is incorporated (e.g., an engine). It is the engine which is the merchandise imported into the U.S. and the subject of an antidumping investigation. The engine is not dumped if it is sold at not less than fair value, even if the valve used in that engine may have been dumped.

b. The downstream dumping provisions are inconsistent with the theory of dumping. The bill would determine whether downstream dumping exists by reference to the "generally available price" of the input in the country where the downstream product is produced. This generally available price apparently would reflect the prices of all of the firms producing the input in that country; in other words it would be a country-wide aggregate.

The use of an aggregate reference price is contrary to the theory of dumping and Article VI:1 of the GATT. Dumping consists of individual firm behavior, and is measured by the firm's price in the home market and in the export market. It is not measured by comparing the firm's price with an aggregate or average of the prices of various other firms.

This departure from economic theory would have two effects: (1) it would penalize efficient firms whose prices and costs are below the industry average (these firms would still be subject to the downstream dumping provisions because their prices were less than the "generally available price"); and (2) it would result in unfairness because a firm could not avoid dumping liability through its own pricing behavior, but instead would be dependent on the pricing behavior of other firms.

c. The downstream dumping provisions of the bill would be impossible to administer in practice. The downstream dumping amendments would require the Department of Commerce to conduct simultaneous dumping investigations of a product and its various allegedly dumped materials and components. A

product with a variety of materials and components would necessarily result in a multiplicity of investigations and a mushrooming of the Department's investigatory responsibilities. The effect would be to introduce additional complexity to investigations that are already subject to stringent statutory time limits. In addition, the bill proposes standards that are unworkable. For example, the administering authority may base the margin of dumping for the dumped material or component on the difference between the foreign market value of such product and either "(1) the generally available price for the product in such country, or (2) if such price is artificially depressed by reason of any subsidy or other sales at below market value, the generally available price for that product that would pertain in such country but for such depression." A generally available price is a theoretical abstraction, particularly in a large country with different markets, buyers, and conditions of sale. In addition, section 104(b) directs the Commerce Department to adjust one theoretical abstraction (the generally available price) by a second, namely the price but for various subsidies or less than fair value sales. The result is likely to be highly arbitrary calculations with no basis in economic reality. Such determinations of dumping would be at serious risk on appeal.

d. <u>The downstream dumping amendments have serious potential for unfairness</u>. A purchaser usually cannot tell if a material or component is being dumped. He or she is unlikely to be aware of the seller's cost of production or home market price. Nevertheless, by purchasing imported materials or components, an innocent producer may unknowingly subject itself to liability for dumping duties. In addition, the seller of the dumped input may well refuse to cooperate with an antidumping investigation. A seller would have little or no incentive to cooperate with a downstream dumping investigation, particularly in view of the burden and expense of such investigations. The purchaser, however, must have the cooperation of the seller of the allegedly dumped material or component to defend against the allegations. In short, the innocent purchaser may be unfairly deprived of any opportunity to mount an effective defense.

e. <u>The enactment of mirror legislation by foreign countries would pose a serious threat to U.S. companies</u>. We know that dumped materials and components are sold in this country. The dumping decisions of the Commerce Department are proof of this fact. If we enact a downstream dumping provision, other countries are likely to adopt mirror legislation. If so, a U.S. producer of washing machines could be subjected to liability for incorporating dumped or subsidized foreign

steel in his product. This risk would be compounded by the inherent arbitrariness of calculations of downstream dumping, and the lack of transparency in many foreign dumping proceedings. We should not enact downstream dumping rules unless we are prepared to live with the same consequences in our own trade.